

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2019-281-S

IN RE:)	
)	<u>PREFILED DIRECT TESTIMONY</u>
Application of Palmetto Utilities, Inc. for)	<u>OF</u>
adjustment of rates and charges for, and)	<u>MARK S. DADAY</u>
modification to certain terms and conditions)	<u>ON BEHALF OF PALMETTO</u>
<u>related to, the provision of sewer service.</u>)	<u>UTILITIES, INC.</u>

1 **Q. PLEASE STATE YOUR NAME, PRESENT POSITION, AND BUSINESS ADDRESS.**

2 A. My name is Mark S. Daday. I am employed as the President and Chief Financial Officer
3 (CFO) of Ni Pacolet Milliken Utilities, LLC (“Ni”) and its subsidiaries, including the
4 applicant, Palmetto Utilities, Inc. (“PUI”). My business address is 1710 Woodcreek Farms
5 Road, Elgin, SC 29045. Ni is owned by Pacolet Milliken, LLC, a South Carolina company
6 owned principally by the Milliken family (“Pacolet”).

7
8 **Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?**

9 A. I graduated from Westminster College in New Wilmington, PA, with a Bachelor of Arts
10 and the University of Miami with an MBA. I have over twelve years of water and
11 wastewater experience and have worked in the utility industry for over 23 years. I was first
12 employed in various financial roles by GATX-Fuller Company, a multi-national
13 manufacturing firm. From 1989 to 2003, I was with Duquesne Light Company, the electric
14 utility serving Pittsburgh, PA. Duquesne was listed on the New York Stock Exchange at
15 the time, and had over 600,000 customers and \$1.1 billion in revenue. I held various
16 positions in the financial group, including Assistant Treasurer, an officer level position. I
17 was one of the founders and a board member of AquaSource, a water and wastewater utility
18 affiliated with Duquesne. AquaSource was involved in over 125 acquisitions and
19 eventually grew to \$200 million in annual revenue. In 1998, I was named CFO of another
20 affiliated company, DQE Systems; subsequently, I was named President. DQE Systems
21 operated a propane gas distribution company and a fiber optic network company in

Pittsburgh. In these roles at DQE Systems, I maintained my involvement with Duquesne Light Company, including serving on its pension investment management committee. In 2010, I joined Ni America Capital Management, LLC, a utility holding company that included PUI among its operating subsidiaries, as CFO. Upon its acquisition by Pacolet, I joined Ni Pacolet and became its President in 2019, while also continuing as CFO.

Q. WHAT ARE YOUR DUTIES IN YOUR CURRENT POSITION?

A. As the Chief Financial Officer of Ni, I am ultimately responsible for all financial issues, and day-to-day financial operations of six utility systems representing over 45,000 equivalent residential connections in South Carolina and Florida. My responsibilities include the day-to-day oversight of its financial, accounting, customer billing and relations, and banking and rates management. As President, I'm the senior executive officer responsible for overall management of PUI, including financial matters, wastewater treatment operations and compliance issues. In the event a customer complaint is not resolved by the Supervisor or Manager of Customer Relations, I speak directly with customers in an effort to resolve their concerns.

Q. HAVE YOU EVER BEEN INVOLVED IN OTHER RATE/ REGULATORY PROCEEDINGS?

A. I have been involved in numerous rate proceedings and settlement negotiations in a number of states, including Pennsylvania, Texas, Florida, and South Carolina. I also participated in Pennsylvania's electric utility deregulation proceedings where, among other duties, I was responsible for Duquesne Light's cost of capital testimony, its testimony related to the proposed 200-mile long Duquesne Light to General Public Utilities Transmission Line, and its fuel clause adjustment filings.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to:

- (1) provide the Commission with background information concerning PUI,
- (2) review specific rate matters related to PUI, its application and proposed rates, and its proposed phase-in of rates generating the proposed revenue requirement,
- (3) document the benefits customers have realized by being customers of PUI following

- 1 the acquisition in 2013 of assets from the City of Columbia by Palmetto of Richland
 2 County LLC ("PRC") for \$18 million and its subsequent ownership by PUI,
 3 (4) explain the reasons why the entire \$18 million paid to the City of Columbia
 4 ("Columbia" or the "City") should be included in the Applicant's rate base for
 5 ratemaking purposes or, alternatively, why only a small portion of that dollar amount
 6 should be excluded from rate base,
 7 (5) explain PUI's position on certain tax matters, and
 8 (6) review expense issues and generally support PUI's need for rate relief.

9 **BACKGROUND**

10 **Q. WHAT IS THE BACKGROUND TO WHICH YOU REFER?**

- 11
 12 **A.** PUI began operating in northeast Richland County in the 1970's under the name
 13 WildeWood Utilities, Inc., and increased in size over time through the acquisition of small
 14 systems and organic customer growth. In 2010, it was purchased by Ni America Capital
 15 Management. In 2012, Ni America Capital Management formed PRC (Palmetto of
 16 Richland County) specifically to purchase wastewater collection facilities (owned by the
 17 City) serving approximately 11,370 customers in an area adjacent to the PUI service area.
 18 This purchase was the subject of the proceeding before the Commission that resulted in the
 19 issuance of Commission Order Number 2012-960. Per the terms of the agreement between
 20 the City and PUI and this Order, PRC continued to charge the acquired customers the rates
 21 then in effect at the City, which consisted of a usage sensitive rate of \$4.93 for every 100
 22 cubic feet (748.052 gallons) of metered water consumption, plus a base facilities charge of
 23 \$10.20. In July 2017, the Commission approved the merger of PRC into PUI, subject to
 24 the requirement that customers previously served by PRC continue to be charged the City's
 25 2012 rate unless and until the Commission approved a new rate for PUI. In 2017, PUI
 26 applied to the Commission for an adjustment of its rates based on a test year ending March
 27 31, 2017, and included in its application a request that a uniform, flat monthly sewer rate
 28 be adopted for all customers. This request was granted by the Commission in its Order
 29 Number 2018-155 dated March 7, 2018 and resulted in PUI's current monthly uniform
 30 service rate of \$52.10 per single family equivalent, or "SFE."
 31

1 **RATE MATTERS**

2

3 **Q. WHEN WAS THE LAST GENERAL RATE INCREASES REQUESTED BY PUI?**

4 A. PUI last requested a general rate increase in August 2017, based on a test year ending

5 March 31, 2017. By Order No. 2018-155, the Commission authorized an increase in PUI's

6 monthly sewer service charge to \$52.10 per SFE effective March 7, 2018. So PUI's current

7 monthly service rates are based on revenue, expense and capital investment data that is

8 outdated by roughly 29 months —and significant changes have occurred during that period.

9

10 **Q. IS PUI IN NEED OF CURRENT RATE RELIEF?**

11 A. Yes. As the financial statements attached as exhibits and schedules to this Application

12 demonstrate, and as the testimony of PUI witness Donald Clayton confirms, PUI is earning

13 far below its previously authorized operating margin of 15%. This is due primarily to

14 increases in its capital expenditures and, to a lesser extent, increases in its operational

15 expenses since its last rate relief proceeding.

16

17 **Q. WHAT RATESETTING METHODOLOGY IS PUI REQUESTING?**

18 A. PUI requests that rates be set in this proceeding using the return on rate base methodology.

19 PUI's substantial investment in rate base of approximately \$11.4 million warrants a rate of

20 return methodology instead of the operating margin methodology. As this Commission has

21 previously observed, the return on rate base methodology is warranted where a utility has

22 a large rate base and needs to earn a rate of return sufficient to obtain the necessary equity

23 and debt capital that a larger utility needs for sound operation. Although the Commission

24 is required to state the resultant operating margin after it determines just and reasonable

25 rates, it should not use operating margin as a guide to set rates where the circumstances

26 justify use of the rate of return method. Given PUI's substantial rate base and its need to

27 earn a reasonable rate of return on its investment, the return on rate base is the appropriate

28 methodology to use in this case.

Q. CAN PUI LESSEN THE CUSTOMER IMPACT OF THE REQUESTED RATE INCREASE?

A. A public utility is entitled to an increase in rates to recover its increased costs of operation and a reasonable return on its investment once the assets have been placed in service (i.e., they are used and useful). Entitlement to rate increases is immediate upon receipt of regulatory approval. However, in an effort to lessen the impact on customers from the rate increase requested, PUI has offered to phase-in the \$14.52 per month increase in three equal amounts of \$4.84 as shown in the table below:

May 2020	\$4.84
May 2021	\$4.84
May 2022	<u>\$4.84</u>
Total	\$14.52

Please note that the proposed phase-in is based upon receipt of 100% the requested rate relief. If approved, this phase-in would be made available without interest (and PUI would not seek an award of carrying-charges on the deferred revenue).

Q. WHY WOULD PUI BE WILLING TO PHASE-IN THE INCREASE IN RATES?

A. PUI recognizes that this increase will have an impact on customers and is simply trying to be mindful of this impact. A phase-in of increased rates described above would cost PUI approximately \$0.5 million in lost carrying charge on revenue based on the difference between the full increase entitled to be implemented upon the order, and the full phase-in in year three. Since the phase-in is being offered without an interest carrying charge, there is an additional cost to PUI measured by the cost of capital on the deferred amount.

INCLUSION OF THE PRC ASSETS IN RATE BASE

Q. ARE THE PRC ASSETS ACQUIRED FROM THE CITY IN 2013 IN PUI'S RATE BASE?

A. No, they are not. As the Commission is aware, it deferred the question of what portion of these facilities should be included in PUI's rate base in the last general rate relief proceeding. Therefore, since 2013, PUI has earned no return on the \$18 million it invested.

1 **Q. WHAT IS PUI'S POSITION REGARDING INCLUSION OF THE PRC ASSETS IN RATE BASE?**

2 A. Our primary position is that the purchase price of \$18 million should be included in rate
3 base because that is the cost PUI incurred to acquire it. As Mr. Walsh discusses in more
4 detail, the 1996 Uniform System of Accounts ("USOA") for Class A Wastewater Utilities
5 adopted by the National Association of Regulatory Utility Commissioners ("NARUC")
6 does not require any adjustments to that \$18 million cost figure because the facilities
7 acquired were not an operating unit or system and were not devoted to utility service by
8 the prior owner, which was the City (and thus was not a utility subject to the Commission's
9 regulation or USOA rules and failed that test).

10 However, if the Commission were to determine that the USOA did apply to the City, and
11 therefore that it was the first to devote these facilities to utility service, the amount which
12 should be included in rate base is the estimated original cost of construction, less
13 depreciation, less appropriate contributions in aid of construction ("CIAC"), all as
14 estimated by Company witnesses Wood, Clayton, and Harold Walker. This comes to \$17.1
15 million to be added to PUI's rate base. This assumes that the Commission does not allow
16 any positive acquisition adjustment as the USOA permits, which PUI believes is warranted
17 under the circumstances in view of the benefits realized by customers from this at-arms-
18 length acquisition.

19
20 **Q. PLEASE EXPLAIN YOUR DETERMINATION TO INCLUDE \$17.1 MILLION IN RATE BASE?**

21 A. PUI purchased the collection assets and the 11,370 customer accounts from the City;
22 however, the City could not provide any separate financial statements or information for
23 these customers. NARUC allows for estimates to be used in the case where financial
24 statements are not available. A Reproduction Cost New Less Depreciation (RCNLD) study
25 was prepared based on reports by two consulting groups. This is a common method of
26 estimation used when financial statements are not available. The results of the RCNLD
27 were audited and accepted by PricewaterhouseCoopers, PUI's independent external
28 auditors, who confirmed to me in writing that this methodology is acceptable for use under
29 accounting procedures applicable to both utilities and non-utilities. I shared that
30 information with ORS.

Witness Joel Wood prepared a study which listed the assets purchased and their cost if reproduced today. Witness Donald Clayton then discounted the cost back to the month and year they were put into service. He then calculated what the depreciation would be from that date until the assets were purchased by PUI in March 2013. This amount went into the opening balance sheet at acquisition date and was \$18.0 million. Though similar in amount, the purchase price played no role in this calculation. Witnesses Wood and Clayton will go into further detail of their procedures in their testimony. To get to the \$17.1 rate base, donated property (donated CIAC) of \$0.9 million was deducted from the \$18.0 million. The donated lift stations were listed in the asset purchase agreement with the City and their RCNLD was calculated similarly to the way the \$18.0 million was calculated using witness Wood's report. PUI maintains that any cash CIAC (City "Expansion Fee") paid by customers went towards the wastewater treatment plant, which PUI did not purchase. Note that the only cash CIAC paid by customers was specifically for "plant expansion" and PRC acquired only the collection system. Witness Harold Walker will further discuss this in his testimony.

CUSTOMER BENEFITS

Q. HOW DO PUI'S SEWER RATES COMPARE TO RATES OF NEIGHBORING UTILITIES?

A. Attached as MD Exhibit 1 is a chart comparing neighboring residential sewer utility rates with PUI's proposed rates. The information in this table was included in the *ex parte* briefing given by PUI to the Commission in September. An updated version of this was shown at the town hall meetings described in Ms. Powell-Baker's testimony. It shows that Palmetto's current rates are below the mid-point of the group and that in year three after the proposed phase-in they will still be in the middle third of the group.

Q WHAT BENEFITS DO FORMER CITY CUSTOMERS RECEIVE AS A RESULT OF BEING SERVED BY PUI?

A. There are several benefits. First and foremost is the financial benefit that the average customer previously served by the City received for the five-year period prior to PUI's last rate case (in March 2018). At the time of 2013 PRC acquisition, PRC customers were

1 paying the City \$49.74 per month for service (based on 6,000 gallons/month of water
2 usage). This was calculated based on the City's consumption charge of \$4.93 for every
3 748.052 gallons (100 cubic feet) of water consumed, plus its base facilities charge of
4 \$10.20. As part of the Commission's approval of the PRC acquisition, the City's rate tariff
5 remained in effect for these 11,370 customers until March 7, 2018. During that five-year
6 period, the City of Columbia raised rates on its out-of-city customers (like those in the PRC
7 service area) three times. After the third increase, the average out-of-city residential
8 customer, using 6,000 gallons of water per month, was paying \$60.75 for monthly sewer
9 service. By contrast, the average customer in the PRC service territory, whether under PRC
10 or PUI, continued to pay only \$49.74. These 11,370 customers collectively saved
11 approximately \$4.2 million (an average of almost \$6.25 per month), by not being City
12 customers during that nearly five-year period. Attached as MD Exhibit 2 is a chart showing
13 the bases for my calculation in this regard.
14

15 **Q. DID THE RATE BENEFIT FOR PRC CUSTOMERS DISAPPEAR IN PUI'S LAST RATE CASE?**

16 A. No, it did not. In fact, since the Commission's approval of PUI's current flat rate of \$52.10
17 per month in March 2018, the City increased its rates two more times, with the average
18 out-of-city customer now paying \$71.40 per month (based on using 6,000 gallons/month
19 of water). Accordingly, as shown on MD-Exhibit 2, PUI's customers formerly served by
20 the City will have saved almost \$4.7 million (an average of almost \$16.23 per month since
21 March 2018) by virtue of no longer being City customers.
22

23 **Q. WHAT IF THE CITY'S RATE DOES NOT INCREASE AGAIN?**

24 A. Even if the City's rate was to stay the same as it is now (such that the average customer
25 continued to pay \$71.40 per month), and PUI is granted the additional requested revenue
26 and an increase is phased in over three years as PUI has proposed, PUI's former City
27 customers will continue to pay less than if they were on the City's system. As shown on
28 MD-Exhibit 2, based on the average consumption, these customers would pay almost \$3.9
29 million less than what would have been collected from them by the City over that three-
30 year period, which saves \$9.62 per month for the average customer.
31

1 **Q. IS IT LIKELY THAT THE CITY WILL INCREASE RATES AGAIN IN THE NEAR FUTURE?**

2 A. Yes. As I testified in PUI's last rate case, there is a \$750 million consent agreement the
 3 City signed with the EPA, which can be found at
 4 <https://www.epa.gov/enforcement/columbia-south-carolina-clean-water-act-settlement>
 5 and <https://www.justice.gov/opa/pr/columbia-sc-agrees-major-sewer-system-upgrades>.
 6 This consent agreement requires significant capital improvements which will undoubtedly
 7 cause the City's rates to continue increasing for the foreseeable future. The City had a 7%
 8 increase in sewer rates in July 2019 and has averaged a 5.4% annual increase over the last
 9 ten years, which was driven by its need to comply with this consent order. A news article
 10 describing the City's need for periodic rate increases may be found at the following link:
 11 [https://www.postandcourier.com/free-times/news/local_and_state_news/columbia-gives-](https://www.postandcourier.com/free-times/news/local_and_state_news/columbia-gives-first-nod-to-water-sewer-rate-hikes/article_4d2b4674-8eb2-11e9-990d-9b574fda971c.html)
 12 [first-nod-to-water-sewer-rate-hikes/article_4d2b4674-8eb2-11e9-990d-](https://www.postandcourier.com/free-times/news/local_and_state_news/columbia-gives-first-nod-to-water-sewer-rate-hikes/article_4d2b4674-8eb2-11e9-990d-9b574fda971c.html)
 13 [9b574fda971c.html](https://www.postandcourier.com/free-times/news/local_and_state_news/columbia-gives-first-nod-to-water-sewer-rate-hikes/article_4d2b4674-8eb2-11e9-990d-9b574fda971c.html). MD-Exhibit 2 shows the impact of annual increases of that amount on
 14 City rates and the accompanying savings its former customers now served by PUI would
 15 realize in each year of the PUI's proposed phase-in. MD-Exhibit 3, attached hereto, sets
 16 forth copies of the City of Columbia ordinances that are referenced in MD-Exhibit 2.

17
 18 **Q. SHOULD PUI'S RATES BE SET BY REFERENCE TO THE CITY OR OTHER UTILITY'S RATES?**

19 A. No, it should not. PUI's rates should be based on a recovery of its own operating expenses
 20 and a reasonable return on its own investment. Although there may be points of comparison
 21 between PUI and other utilities, we believe that our request for rate relief should be judged
 22 on its own merits. Having said that, we do believe it is appropriate to consider the benefits
 23 that have been realized, and will continue to be realized, by our customers in the area
 24 formerly served by the City.

25
 26 **Q. ARE THE RATES AND CHARGES PROPOSED FAIR, REASONABLE, AND NECESSARY IN ORDER**
 27 **FOR PUI TO CONTINUE TO PROVIDE A SAFE AND RELIABLE WASTEWATER SERVICES?**

28 A. Yes. The financial statements and the testimony of Mr. Clayton clearly reflect the financial
 29 position of PUI as Applicant. In order to continue to provide the type of services which we
 30 have been providing, PUI must have rate relief. PUI believes that the proposed rates fairly
 31 distribute the cost to the consumer of providing those services, while at the same time

1 placing the utility on a more solid financial footing. This will allow PUI to attract additional
2 capital to continue financing operations and fund future capital expenditures. PUI is
3 committed to continuing to provide quality service in an environmentally responsible
4 manner. It is our belief that the rates requested are reasonable, fair, responsible, non-
5 discriminatory and justified in light of (i) customer needs, (ii) PUI's requirements to meet
6 the customers' needs, and (iii) its commitment to do so in compliance with regulations of
7 this Commission, DHEC, and other applicable regulatory agencies.

8
9 **Q. WHAT IS YOUR UNDERSTANDING OF ORS' POSITION REGARDING HOW THE COMMISSION**
10 **SHOULD ADDRESS THE IMPACT OF THE TAX CUTS AND JOBS ACT ("TCJA") WHICH TOOK**
11 **EFFECT JANUARY 1, 2018?**

12 A. My understanding is that ORS believes that customers are due a refund for a portion of the
13 revenue collected by PUI beginning January 1, 2018 because PUI's rates include an
14 expense for income tax which was based on the former, higher income tax rates.

15
16 **Q. DOES PUI AGREE WITH ORS' POSITION?**

17 A. No, it does not. ORS's position would require the Commission to engage in impermissible
18 retroactive ratemaking, single expense ratemaking, and an improper modification of prior,
19 lawfully approved rates. PUI has used the lower federal tax rate (21%) going forward in
20 this rate case. PUI witness Walsh discusses this further in his testimony.

21
22 **Q. WHAT IS PUI'S POSITION REGARDING ADJUSTING ACCUMULATED DEFERRED INCOME**
23 **TAX FOR THE TCJA?**

24 A. PUI agrees that the balance of Accumulated Deferred Income Taxes should be reduced as
25 of the date of this order based on the lower federal income tax rate. The adjustment and
26 proposed timeframe to return to customers was calculated as of December 31, 2018 and
27 attached here as MD Exhibit 4.

EXPENSE ISSUES

Q. DISCUSS PUI'S TOTAL OPERATING EXPENSE SINCE THE LAST RATE CASE.

A. Since the last rate case, operating expenses (which includes O&M, depreciation, property taxes and income taxes) have increased by approximately \$2.5 million. The main drivers of this increase in expenses were higher property taxes and increased sludge disposal and chemical costs mostly due to the expansion of the Spears Creek wastewater treatment plant.

Q. DOES PUI HAVE ANY TRANSACTIONS WITH AFFILIATED COMPANIES?

A. Yes, it does. PUI treats and disposes of wastewater received from Ni South Carolina Environmental Services, LLC ("Ni-Enviro"), a sister company owned by Ni, which operates a septage receiving station that takes wastewater and solids from septic tanks or other sources. PUI believes that the charges it imposes for treating and disposing of wastewater from Ni-Enviro are reasonable and appropriate.

Q. WHAT ARE THOSE CHARGES?

A. PUI charges Ni-Enviro the Commission-approved rate for wastewater treatment service -- currently \$52.10 per single family equivalent ("SFE"). The number of SFEs was determined originally by taking the total gallons expected to be treated, and dividing that by the 300 gallon capacity loading guideline per SFE. In addition, PUI allocates to Ni-Enviro, a portion of the charges PUI incurs for purchased power and materials & supplies. The amounts of those allocations are an average of \$3,245 and \$100 per month respectively. This amount is the only cost PUI incurs to operate the septage receiving station.

Q. ARE THERE ANY OTHER TRANSACTIONS WITH AFFILIATES?

A. Yes. PUI is charged for utilizing 3,299 square feet of office space at 1710 Woodcreek Farms Road, which is owned by 1710 Woodcreek Farms Road, LLC ("Woodcreek"). Woodcreek is a sister entity to PUI, and an indirect subsidiary of Ni.

1 **Q. WHAT IS PUI CHARGED FOR THE WOODCREEK OFFICE SPACE?**

2 A. PUI is charged \$19.09/square foot, which includes real property taxes of \$11,264 and
3 depreciation expense of \$24,893. PUI believes that this charge is reasonable given that
4 comparable office space nearby is leasing for \$20.00/square foot.
5

6 **Q. WHY DID YOU ADD A TAMPERING CHARGE TO YOUR RATE TARIFF?**

7 A. PUI added a charge not to exceed \$250 for any customer who tampers with or damages
8 PUI's facilities or equipment. This was added to deter this type of behavior and is similar
9 to provisions that the Commission has approve for other sewer utilities.
10

11 **Q. WHY IS THE COMPANY PROPOSING LANGUAGE INCORPORATING A LIMITATION ON**
12 **LIABILITY IN INSTANCES WHERE SERVICE IS INTERRUPTED?**

13 A. This language is consistent with that approved by the Commission – without objection, I
14 would note – for other wastewater utilities and is intended to make clear that the
15 Company's only obligation regarding service interruption is to comply with the
16 Commission's service interruption regulations. While this will preclude any claim based
17 simply upon the fact that a service interruption occurred, it does not limit a customer's right
18 to bring a claim for damages if they result from a service interruption.
19

20 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

21 A. Yes, it does.